

3.02 Investments in Debt Securities – Available for Sale

Accounting for Available-For-Sale Securities

Available-for-sale (AFS) debt securities are those that do not fall into either the trading or held-to-maturity categories. AFS securities are similar to trading securities in that they are likely to be sold prior to maturity.

Balance Sheet

AFS securities are initially recorded at cost but are carried at fair value (ASC 320), with the amortized cost basis and the allowance for credit losses reported parenthetically.

- Changes in market price (ie, fair value) and credit losses are reflected whenever the entity prepares the F/S.

AFS securities may be classified as current or noncurrent, depending on the expected holding period.

- Generally considered noncurrent if the holding period is indefinite.
- AFS securities are not purchased primarily to gain short-term profits from resale and are not reported as current assets until management has decided to dispose of them, or otherwise believes they will be disposed of, within one year.

Unrealized gains/losses resulting from fluctuations in fair value must be evaluated to determine whether any portion is due to credit losses (reported in income). Any remaining increases/decreases in the fair values of AFS securities are not reported in income until the securities are disposed of. Instead, they are included in other comprehensive income (OCI) on the statement of comprehensive income and accumulated in the equity section of the B/S as accumulated OCI (AOCI).

- Unrealized losses in excess of credit losses are reported as a reduction to the investment in a contra-asset account—we'll call it *AFS securities – unrealized losses*. Similarly, unrealized gains are recognized as an increase to the investment account in a valuation account, *AFS securities – unrealized gains*.
 - If FV is lower than the original cost, the difference, net of credit losses, is credited to *AFS securities – unrealized losses*.
 - If FV is higher than the original cost, the difference is debited to *AFS securities – unrealized gains*.
 - If FV is lower in one period and higher in a subsequent period, the *AFS securities – unrealized losses* account is eliminated, and the excess is recognized in *AFS securities – unrealized gains*.
 - If FV is higher in one period and lower in a subsequent period, the *AFS securities – unrealized gains* account is eliminated, and the excess is recognized in *AFS securities – unrealized losses*.

Income Statement

The increase/decrease in the allowance for credit losses will be reported on the income statement (I/S) in the period of the change as credit loss expense or reversal of credit loss expense, respectively. Realized gains and losses also appear on the I/S as does interest income.

Statement of Cash Flows

Cash flows related to the acquisition (outflows) and disposal (inflows) of AFS investments are reported as investing activities on the statement of cash flows.

Same example as above, except for the treatment of the unrealized gain and loss (not due to credit losses).

To purchase:

Investment in AFS security	100	
Cash		100

At 12/X1, the fair value is now \$140. Since the security is required to be reported at fair value, the increase is recorded in the investment account, or set up as a valuation allowance.

Market Adjustment – AFS Security (B/S)	40	
Unrealized Gain (Stmnt of comp inc)		40

The market adjustment account is on the B/S and increases the carrying value of the AFS security in the asset section. The unrealized gain is reported on the statement of comprehensive income as a component of OCI and accumulated in the stockholders' equity section of the balance sheet in Accumulated OCI.

At 12/X2, the fair value is now \$90, resulting in a loss of \$50 (\$140 – \$90).

Unrealized Loss (Stmnt of comp inc)	50	
Market Adjustment – AFS Security (B/S)		50

Note: The unrealized gain in 20X1 of \$40, and the unrealized loss in 20X2 of (\$50), are reported in OCI in each period's statement of comprehensive income. The amount is accumulated in a stockholders' equity account (Accumulated OCI) on the B/S. The amount, which is the same as the balance in the valuation account, is a negative equity amount (debit balance) of \$10.

GAAP Statement of Comprehensive Income (ON-TIDe-N-OC)	20X1	20X2	
Operating Income			
Nonoperating	40	(50)	If Trading, goes here
<u>Taxes</u>			
Income continuing operations			
<u>Discontinued Operations</u>			
Net Income	100	200	300 to RE
<u>Other Comprehensive Income (OCI)</u>	<u>40</u>	<u>(50)</u>	<u>(10) Accumulated OCI</u>
Comprehensive Income	140	150	290 net effect on B/S

When an entity has items to be reported in OCI, they are reported separately from items that are recognized in earnings. The above items may be presented in a single statement of comprehensive income, as shown, or in two separate statements, as follows:

- Income statement (aka, statement of earnings or statement of operations) – Includes all elements leading to net income or “earnings.”
- Statement of comprehensive income – Immediately follows the income statement when both statements are presented. It combines net income with other comprehensive income items to determine comprehensive income.